

This letter discusses whether flowline systems, grading systems, portioning systems, weighing systems, and operating software for use in the processing of meat, poultry, and fish can qualify as manufacturing machinery and equipment. See 86 Ill. Adm. Code 130.330. (This is a PLR).

December 19, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of July 11, 2001 and the additional material provided November 15, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to AAA for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

In accordance with your suggestion contained in the General Information Letter that we received, we hereby request a formal, binding Private Letter Ruling pursuant to 86 Ill Adm. Code Section 1200.110 and subsection (b)(1) through (8) thereof. We represent AAA, a regular corporation incorporated under the laws of the STATE on June 1, 1995. This request is based upon the facts previously presented in the February 7, 2001 technical request email submitted to your office, a copy of which we attach hereto and incorporate herein by reference. This request is based also upon more detailed facts contained herein pursuant to your instructions in the April 5, 2001 General Information Letter response. The Taxpayer is not under audit although it has begun the voluntary disclosure process. As part of that process Taxpayer is attempting to confirm the exempt nature of what it sells.

#### ADDITIONAL FACTS, DISCUSSION, AND QUESTIONS PRESENTED

##### *MACHINERY AND EQUIPMENT*

Taxpayer's primary business is the sale, installation and repair of high-tech, industrial grade processing machinery and equipment. The machinery and equipment Taxpayer sells includes the software to run the machinery and equipment and the spare parts necessary to keep the machinery and equipment running. Taxpayer purchases this machinery and equipment from its parent company, BBB, and then resells it to

Taxpayer's customers throughout the United States. The purchase and resale functions may be unclear from the February 7, 2001, technical request. Nevertheless, that is the case. Taxpayer purchases everything that it sells from its parent company. The machinery and equipment is drop-shipped directly from PLACE to Taxpayer's customers in the United States.

Taxpayer's company is recognized as the 'weighing, vision technology and software specialist' of the industry. The parent company designs and manufactures integrated processing systems including weighing and monitoring equipment, scales, software, intelligent portioning, and grading modules. Machinery and equipment produced is used primarily by Taxpayer's customers in all stages of the processing cycle, thereby increasing Taxpayer's customers' productivity and profitability.

Taxpayer sells software that is an integral part of the machinery and equipment sold to its customers. The software Taxpayer sells to make its machinery and equipment run is 'tailor designed software for each individual client depending upon the application.' Taxpayer also provides installation and repair services as well as technical support to its customers.

Among Taxpayer's products are the following:

- \*\*\*Equipment
- \*\*\*Systems
- \*\*\*
- \*\*\*Systems
- \*\*\*Flowlines
- \*\*\*Machines
- \*\*\*Systems

Illustrative examples of machinery and equipment Taxpayer sells are the ITEM1 and the ITEM2. The machinery and equipment is described in company marketing materials as follows:

#### ITEM1

*In recent years buyer requirements have become more specialized regarding shape and weight of pieces, pack weights, quantity and size of pieces in a pack. In addition, quality demands have increased. AAA's item 1 was designed precisely to fulfill these requirements. The system transports and processes raw material gently and efficiently through the various processing stages, keeping to an absolute minimum the time that raw material stops at a processing station. Raw material is weighed, graded, cut and packed in one continuous flow, which increases capacity by 50-80% per man-hour.*

#### ITEM2

*Developed, tried and tested, the AAA ITEM2 represents the most advanced range of weight graders available on the market today. High-speed, high-precision weighing units offering an accuracy rate from +/-1 gram and a capacity of up to 500 pc/min on a dual-lane unit, depending on the material being processed, AAA ITEM2 offer the additional option of grading products by size and shape, as well as weight.*

Taxpayer sells its machinery and equipment both to retailers and to industrial producers. The latter group of customers resells their food products to retailers. We believe that the equipment Taxpayer sells is used by its customers 'primarily' (i.e., over 50 percent of the time) in 'manufacturing' i.e., in changing the products into items with different forms and names). Any use of machinery and equipment for labeling and data collection is always as part of its customers' integrated manufacturing process.

Are the machines, equipment, related software and the repair and replacement parts sold by AAA 'manufacturing machinery and equipment'? If so, are the services performed to install or repair the machinery and equipment or to provide technical support also exempt?

Assuming that the above answer is in the affirmative, we understand from your General Information Letter that Taxpayer's sales of this machinery, equipment, software and repair parts to industrial producers who make sales for resale are exempt, but that Taxpayer's sales of these very same items directly to retailers are not exempt. Is this correct?

Finally, are Taxpayer's sales to purchasers with Illinois E numbers exempt, such as sales of equipment to cafeterias or to religious orders for use by them in their industrial kitchens?

## SOFTWARE

The software that Taxpayer's sells along with its machinery and equipment helps to make these products run. The software, generally speaking, is canned software; however, customized work is often needed to get that software running on a customer's overall system. Moreover, in some cases, the software is primarily customized software to meet the needs of a particular client. In all events, the software is used in a manner analogous to the way in which software is used in a CAD/CAM operation.

An illustrative example of software Taxpayer sells to its customers as an integral part of processing system is the SOFTWARE. That software is described in company marketing materials as follows:

### Software

*The Software is designed specifically for use with AAA grading equipment. Using the system, operators can retrieve precise, up-to-the-minute information on the grading and batching process. This data can then be used to control grader settings from single or multiple locations. The new software connects to every AAA Grader, both new and old. It collects data from grading units, saves information on settings and continuously monitors the entire grading and batching process. All registrations are saved in a powerful database. Reports can then be generated whenever required from the stored information.*

Does the software Taxpayer sells fall within the exclusion for 'software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease'? If so, do the services performed to install or repair or to provide technical support fall within this exclusion?

Thank you for your assistance in this matter. Please telephone with any questions or request for further information. Further, we request a conference should you decide that you are tentatively adverse to our ruling requests.

There is contained herein no trade secret information that AAA seeks to be deleted from any publicly disseminated version of the Private Letter Ruling that taxpayer seeks. However, please be certain to delete not only taxpayer's name but its website address, the names of the various manufacturing machinery, equipment, software and parts that are referenced in the context of the Private Letter Ruling and any other identifying language as well.

#### **DEPARTMENT RESPONSE:**

Machinery and equipment that is used primarily (over 50% of the time) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease is exempt from Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.330. The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use, or name. These changes must result from the process in question and be substantial and significant. See Section 130.330(b)(2).

The preparation of food and beverages by restaurants, food service establishments, and other retailers is not manufacturing. See Section 130.330(b)(7). Therefore, sales of this machinery, equipment, software and repair parts are subject to tax when made to restaurants, food service establishments and retailers.

Under Section 130.330(d), the following activities by manufacturers will generally be considered to constitute an exempt use:

- (A) The use of machinery or equipment to effect a direct and immediate physical change upon the tangible personal property to be sold;
- (B) The use of machinery or equipment to guide or measure a direct and immediate physical change upon the tangible personal property to be sold, provided such function is an integral and essential part of tuning, verifying, or aligning the component parts of such property;
- (C) The use of machinery or equipment to inspect, test or measure the tangible personal property to be sold where such function is an integral part of the production flow;
- (D) The use of machinery and equipment to convey, handle, or transport the tangible personal property to be sold within production stations on the production line or directly between such production stations or buildings within the same plant;
- (E) The use of machinery or equipment to place the tangible personal property to be sold into the container, package, or wrapping in which such property is normally sold where such machinery or equipment is used as a part of an integrated manufacturing process.

The machinery and equipment under review in this Private Letter Ruling includes systems, grading systems, portioning systems, weighing systems, and operating software for use in the processing of product. As we understand it, the processing starts with ITEMS ready to be processed and ends with the packaging of products. Your letter states that the equipment is used primarily in processing products for subsequent retail or wholesale sale, as, for example, in a plant. It is not used primarily in preparation of these products as, for example, in a restaurant as contemplated by Section 130.330(b)(7).

The flowline systems convey the products through the processing stations where the products are graded, portioned, weighed and packaged. At various points in the process, the products are acted upon by such machinery and equipment. The EQUIPMENT, the automatic take-away system, the automatic packing/bagging machines, and the taping/strapping machines. All of this machinery and equipment can qualify for the exemption when used in an exempt manner.

The definition of equipment for the manufacturing machinery and equipment exemption includes any independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process: including computers used primarily in a manufacturer's computer assisted design, computer assisted manufacturing (CAD/CAM) system. See 35 ILCS 120/2-45(4). In addition, Section 2-25 of the Retailers' Occupation Tax Act, 35 ILC 120/2-25, provides that the term "computer software" for purposes of the Act does not include "software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease." If canned computer software is used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, then it may also not be subject to tax. It is our opinion that the EQUIPMENT, which are used to control and monitor the processing system, qualify as exempt. Installation charges for exempt software are exempt, as well.

With regard to installation charges for machinery, such charges are included in the sellers' gross receipts for sales tax purposes if the charges are part of the selling price of the tangible personal property. However, if the installation charge is not a part of the selling price and is instead a service charge separately contracted for between the buyer and the seller, such charge does not need to be included in the figure upon which the seller computes the sales tax liability. See 86 Ill. Adm. Code 130.450(b). Charges that are separately listed on an invoice and initialed by the customer are sufficient to show a separate contract. In the case of a sale of exempt manufacturing machinery and equipment, installation charges that are part of the selling price of the equipment are also exempt from sales tax.

With regard to sales of manufacturing machinery and equipment to exclusively charitable organizations, it is unlikely that sales of the type of processing equipment reviewed in this letter to such organizations for use in their cafeterias would qualify for exemption as manufacturing machinery and equipment. However, if such organizations apply to the Department and obtain a tax exemption identification number ("E" number), such organizations are exempt from incurring sales tax when purchasing tangible personal property in furtherance of their organizational purposes. See 86 Ill. Adm. Code 130.2005 and 130.2007.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.